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Opening Comments
Senate Finance Committee Hearing
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My name is Carol Markman. I am the Chairperson of the National Tax Policy Committee and a Board Member of the only professional organization representing only Certified Public Accountants in Public Practice, the National Conference of CPA Practitioners, NCCPAP. Accompanying me is Robert Goldfarb, the President of NCCPAP, and Alan Feldstein, Vice President of our national organization. Mr. Goldfarb was recently named as one of the 100 most influential accountants in America. He is also a past Chairperson of our National Tax Policy committee. Mr. Feldstein is a member of our National Tax Policy Committee and our Legislative Liaison.

The membership of NCCPAP consists of Certified Public Accountants in public practice located throughout the United States with a concentration of chapters in the Northeast section of the country. Many of our members are also members of the American Institute of CPAs (AICPA), an organization with which you are already familiar. The AICPA's membership includes practicing CPAs, but also includes non-practicing CPAs, such as educators, accountants in private industry and government. More that 65% of the total AICPA membership do not service the public. The members of NCCPAP deal with the Internal Revenue Code on a daily basis directly with the public! We live the Internal Revenue Code every day and sort through its complexities constantly. We estimate that our members serve more than 500,000 businesses and individual clients throughout every state of the country. We appreciate the invitation to participate in this hearing.

Until the Tax Reform Act of 1986 was enacted, if there was a deduction or credit in the tax code, it was available equally to almost every taxpayer without regard to their adjusted gross income. The 1986 Act changed the tax code from 15 brackets ranging from 11 to 50 percent to two brackets, 15 and 28 percent. The offset to this simple rate structure was the beginning of the phase-ins and phase-outs of deductions and credits. In 1988, for the first time, the personal exemptions, then $1,950, began to be phased out when the adjusted gross income for a joint filer was $149,250 and completely eliminated when income exceeded $171,650. Most miscellaneous itemized deductions including unreimbursed employee business expenses were deductible only to the extent that they exceeded two percent of adjusted gross income. Beginning in 1987, only eighty percent of business meals and entertainment expenses were deductible. For the first time, only taxpayers who were not active participants in an employer pension plan and those with very limited incomes could make

deductible IRA contributions. The deductions for sales taxes, credit card interest and other consumer interest were eliminated and many other changes were made to the Tax Code. Also the Alternative Minimum Tax rate was set at 21 percent.

Beginning in 1991, taxpayers with income above an "applicable amount" ($100,000 for all taxpayers except married filing separately) began to lose a portion of their itemized deductions. This limitation is calculated after all the other limitations. Up to eighty percent (80%) of itemized deductions can be lost as a result of this provision.

Since that time, tax rates have increased to a current maximum rate of 39.6 percent but the phase-outs have proliferated effectively raising this marginal tax rate beyond the stated rate of 39.6 percent. As new tax benefits have been introduced, many are limited by adjusted gross income. The public's perception is that the tax code gives benefits, deductions and credits with one hand and takes them away with the other. There are some provisions of the tax code such as the education credits that, in our experience, are available only to taxpayers such as single parents who receive untaxed child support. A newly married couple with wages of $60,000 for the husband and $55,000 for the wife who rent an apartment in New York City are precluded from deducting the $1,400 in student loan interest that they paid.

Deductible IRA contributions can be made by divorced individuals who receive alimony payments from their former spouse but is not available to very many other taxpayers. Other taxpayers that have the funds available to make the IRA contributions are not permitted to do so because they have pension plans at their place of employment. A taxpayer that would prefer to make an IRA contribution early in the year to take advantage of the tax deferral may not be able to do so because an unexpected event at the end of year may render the IRA contribution ineligible.

The attached chart details some of the current phase-outs. Many of these are based on filing status. Others are different only for married taxpayers filing separately. Some phase-outs have kept pace with inflation others have not. As you can see from the attached chart, the phase-out ranges are different for various deductions and credits, even for the same filing status. This causes additional confusion and complexity. Additionally some phase-out ranges are $10,000, others are $15,000 and still others are $25,000. The phase-out range for Alternative Minimum Tax can be as much as $180,000.

One of the most serious problems with the phase-outs is that even a seasoned tax professional cannot sit down with a married taxpayer and prepare a tax return or projection if their income is above $52,000 using only a pencil, paper and calculator. The code is so complex and provides for so many phase-outs with different ranges, and different beginning and ending points. It is impossible to

prepare even a tax projection without being armed with a series of worksheets, schedules and charts. Some phase-out limits change annually, others do not, so the preparer can never be sure of the applicable limits for specific phase-outs without resorting to numerous reference materials.

One example, identified by one of our members, concerns Qualified Performing Artists. Code section 62(b)(1) and (3) of the 1986 Tax Act defines the term "qualified performing artist". The section permits an above the line deduction for the professional expenses of a performing artist but only if the individual's adjusted gross income is below $16,000. The constraints of this provision are so narrow as to preclude any benefit to the vast majority of low income performing artists who live in high cost areas such as California, Massachusetts, Texas or New York. This is a perfect example of giving with one hand and taking away with the other.

During the last several years NCCPAP developed the following related issues:

The Taxpayer Relief Act of 1997 established education incentives in the form of tax credits for qualified tuition and related expenses to eligible post-secondary educational institutions. These credits were designed to benefit low and middle-income taxpayers. Income limits were established for single taxpayers with the phase-out beginning at $40,000 of AGI and ending at $50,000 of AGI. For married taxpayers filing jointly, these phase-out levels were doubled. The Act did not differentiate between a single taxpayer and a single taxpayer with dependent children (Head of Household). The cost of living is significantly different when an individual must pay maintenance for additional family members yet they are subject to the same phase-out limits as a single taxpayer. An expense such as child care so that the parent can go to school is not considered. Code Section 25A should be expanded to permit taxpayers claiming Head of Household status a higher income phase-out than single taxpayers in order to allow more single parents to claim tuition tax credits or the phase-outs for education credits should be made uniform or eliminated.

The phase-out provisions exacerbate the problem of the marriage penalty. The present tax system of separate tax tables and schedules for single and married taxpayers has its roots back in the Tax Reform Act of 1969. At that time the majority of households had a single wage earner. Currently, a single individual taxpayer has a standard deduction of $4,400 and an initial tax rate of 15% for taxable income up to $26,250 and a tax rate of 28% for the next $37,300 of taxable income. A married couple has a standard deduction of $7,350 and an initial 15% tax rate on their first $43,850 of taxable income and a 28% tax rate on the next $62,100 of their taxable income. Exemptions are phased out for "high-income" taxpayers beginning at $128,900 for a single taxpayer and $193,400 for joint filers. The reduction of itemized deductions for "high-income" taxpayers begins when adjusted gross income exceeds $128,950 whether single or married filing jointly.

Another issue previously identified by NCCPAP is the treatment of employee business expenses. Internal Revenue Code section 67(a) requires an employee, who incurs ordinary and necessary business expenses in the performance of his/her duties who are not reimbursed by his/her employer to list those expenses on Form 2106. This total is transferred to Form 1040, Schedule A, as a miscellaneous itemized deduction which is required to be reduced by two percent (2%) of the taxpayer's adjusted gross income. The deduction for these expenses can be further reduced by the phase-out of itemized deductions. In many cases these reductions cause the expenses to be eliminated and the employee is denied these legitimate deductions for tax purposes. In addition, employee business deductions are not an allowable expense for AMT purposes.

"Statutory Employees" and businesses in all forms, i.e., corporations, partnerships, LLC's, LLP's and sole proprietorships, are allowed to deduct all business expenses in full against gross income (subject to certain limitations such as 50% of business meals and entertainment that effect all taxpayers equally). The only business expense not allowed to be deducted in full are those incurred by employees. This is unfair to the typical wage earner.

The total of all employee business expenses listed on Form 2106 should be allowed as a deduction before arriving at Adjusted Gross Income. It should not be listed on Form 1040, Schedule A, as a miscellaneous itemized deduction, nor be an addback for the Alternative Minimum Tax.

The phase-outs have an erosive effect on tax compliance and tax practitioners are forced to tell clients that many tax saving provisions that they read about in the press at this time of the year do not apply to them. They are considered "rich" yet struggle to make ends meet living an ordinary life style in high-income states. My colleagues and I think it is prudent to permit taxpayers to utilize the deductions and credits currently available in the tax law before focusing on lower tax rates. The elimination of the phase-outs will simplify the tax law and make it fairer.

If the phase-outs must be continued, then there should be a uniform phase-out limit for most provisions and the limits should be adjusted to reflect the costs in high tax states.

Respectfully submitted,

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on behalf of the National Conference of CPA Practitioners